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In the Supreme Court of the United States

OCTOBER TERM, 1943

No. 565

WISCONSIN GAS & ELECTRIC COMPANY, PETITIONER

v.

THE UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the District Court (R. 6–8) is reported in 46 F. Supp. 929. The opinion of the Circuit Court of Appeals (R. 20–23) is reported in 138 F. 2d 597.

JURISDICTION

Judgment of the Circuit Court of Appeals was entered on November 8, 1943. (R. 23.) The petition for writ of certiorari was filed on December 30, 1943, and was granted on January 31, 1944. The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the Wisconsin Gas and Electric Company, in computing its net income for the year 1935, is entitled under Section 23 (c) or (d) of the Revenue Act of 1934 to a deduction for amounts paid to the State of Wisconsin pursuant to the privilege dividend tax law of that state.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in Appendix A, *infra*, pp. 38–42.

STATEMENT

This is an action against the United States under Section 24, paragraph Twentieth of the Judicial Code, as amended (28 U. S. C., Sec. 41 (20)), to recover federal income taxes for the year 1935 alleged to have been erroneously assessed and collected. (R. 2–3.) The facts were stipulated (R. 5–6) and the findings of fact by the District Court (R. 9–10) are in accord with the stipulation.

The taxpayer is a corporation under the laws of the State of Wisconsin, and its business, that of a public utility corporation, is conducted wholly within that state. (R. 5, 9.) There was no finding that any of its stockholders are non-residents of Wisconsin. (R. 23.) In its federal income tax return for the year 1935 based on the accrual method, it claimed as a deduction the Wisconsin privilege dividend tax of $3,750 for the year 1935 paid to the State of Wisconsin,

which was assessed and computed in accordance with the Laws of Wisconsin (1935), c. 505, as amended by Laws of Wisconsin (1935), c. 552. (R. 5, 9.) The deduction claimed was disallowed by the internal revenue agent, and this, together with other disallowances, resulted in the determination of an additional tax of $11,696. (R. 5–6.) The additional tax thus determined was paid by the taxpayer (R. 6, 9) and a timely claim for refund filed, which was rejected (R. 6).

The present action is to recover $515.63 in federal income taxes due solely to the disallowance of the claimed deduction of the Wisconsin privilege dividend tax. (R. 6, 9.) The District Court rendered an opinion (R. 6–8) sustaining the taxpayer's claim, judgment in its favor (R. 10–11) being entered October 6, 1942. On appeal to the Circuit Court of Appeals for the Seventh Circuit that court on November 8, 1943, rendered its opinion and judgment (R. 20–23) reversing the judgment of the District Court. The case is brought to this Court by a petition for certiorari by the taxpayer granted January 31, 1944.

SUMMARY OF ARGUMENT

I

A taxpayer, in order to deduct under Section 23 (c) "taxes paid or accrued," must show that the tax is imposed upon it. This is the uniform construction of the section in the Treasury Regulations which has been accepted and applied by

this Court. In determining for the above purpose the person upon whom a particular state tax is imposed, the federal courts will be guided by the state statute as interpreted and applied by the courts of the state.

The clear wording of the Wisconsin statute enacting the privilege dividend tax here in question shows that the tax is not imposed upon the corporation but upon the shareholders who receive the dividends. The tax is deducted and withheld from the dividends paid the shareholders. The Wisconsin Supreme Court has held that the tax in question is imposed on the shareholders and not upon the corporation. This was not merely a matter of terminology but was essential to the decisions of that court holding that the tax was not deductible by a corporation for purposes of the state income tax and that a corporation might properly deduct it from preferred dividends which it declared.

The decision of this Court in *Wisconsin* v. *J. C. Penney Co.*, 311 U. S. 435, is not to the contrary. That decision involved merely the *power* of the state to impose the tax in question. It held that since the state would have had power to assess an additional tax on the corporate earnings and since the tax in question was confined to such earnings, the tax bore a fiscal relation to protection, opportunities and benefits given by the state, and was therefore within the state's constitutional

power. The Court did not, insofar as the question here involved was concerned, depart from its holdings that for the purpose of tax deductions under the federal income tax law, the incidence of state taxes is to be determined by the state law. The decision of this Court in *Biddle* v. *Commissioner*, 302 U. S. 573, involved a concept of British tax law, not accepted in the United States, whereby for certain tax purposes the corporation and shareholders are treated as a single entity. The refusal of the Court in that case to adopt that concept and thus to allow a credit to stockholders has no bearing on the instant case, which involves a familiar tax system under which the corporation is the withholding and collecting agent with respect to distinct taxes imposed on the shareholders.

II

Section 23 (d) of the Revenue Act relates to deductions by corporations of taxes paid by them on the shares of the stockholders as property, and is not applicable to the present case. Moreover, deductions under this section are confined to taxes paid by the corporation for which it has not been reimbursed by the shareholders. By the deduction of the privilege dividend tax from the dividends paid to the shareholders, the taxpayer corporation in the present case was reimbursed for the taxes paid by it.

ARGUMENT

I

THE WISCONSIN PRIVILEGE DIVIDEND TAX IS NOT IMPOSED UPON THE CORPORATION BUT UPON THE SHAREHOLDERS, AND IS THEREFORE NOT A TAX DEDUCTIBLE BY THE CORPORATION UNDER THE PROVISIONS OF SECTION 23 (C) OF THE REVENUE ACT

The Government's position in this case can be succinctly and simply stated. Under the federal income tax law and the applicable regulations, taxes may be deducted from gross income only by those persons upon whom they are "imposed." The ascertainment of the person upon whom the tax is imposed is determinable by the decisions of the courts of the state which imposed the tax in question. The Wisconsin privilege dividend tax here involved is by its terms, and as construed by the Supreme Court of Wisconsin, clearly imposed upon the shareholders of the corporation and not upon the corporation itself. Neither the decision of this Court in *Wisconsin* v. *J. C. Penney Co.*, 311 U. S. 435, sustaining the constitutional power of the state to levy the tax in question, nor the decision of this Court in *Biddle* v. *Commissioner*, 302 U. S. 573, requires a contrary holding. Therefore the decision of the Circuit Court of Appeals holding that petitioner was not entitled to the deduction claimed is correct and should be affirmed. These points will be discussed in the argument following in their appropriate order.

1. *Taxes are deductible only by the person upon whom they are imposed*

Section 23 of the Revenue Act of 1934 here involved (Appendix A, *infra*, p. 38), insofar as here material, provides that in computing net income there shall be allowed as deductions "Taxes paid or accrued within the taxable year."[1] This tax deduction privilege has been phrased in the identical simple form since the Revenue Act of 1921,[2] and is so phrased today in the Internal Revenue Code.[3] This section of the various revenue laws has, however, for a long period been implemented and construed by the Treasury Regulations promulgated under the authority of Congress. Article 131 of Regulations 65, issued under the Revenue Act of 1924, provided in part as follows: "Taxes are deductible as such only by the person upon whom they are imposed." Article 151 of Treasury Regulations 74, promulgated under the Revenue Act of 1928, provided as follows: "In general taxes are deductible only by the person upon whom they are imposed." The same words have been contained in the Treasury Regulations ever since, including Article 23 (c)-1 of Treasury

[1] This section, as well as the comparable sections of the Revenue Acts for other years and of the Internal Revenue Code, contains certain exceptions to this general rule. The exceptions, however, are not material to the present case.

[2] See Revenue Act of 1921, c. 136, 42 Stat. 227, Secs. 214 (a) (3) and 234 (a) (3).

[3] See Internal Revenue Code, as amended, Sec. 23 (c).

Regulations 86 (Appendix A, *infra* p. 38) applicable to the tax year here in question, and Section 29.23 (c)–1 of the current Treasury Regulations 111, promulgated under the authority of the Internal Revenue Code.[4] In these circumstances this regulation has the force of law,[5] as was expressly recognized in *Magruder* v. *Supplee*, 316 U. S. 394, 396, where this Court said, in considering the statutory provision here involved:

> The guiding principle for determining whether a payment satisfying a tax liability is a "tax paid" within the meaning of Section 23 (c) is furnished by the applicable Treasury regulation, which states that "In general taxes are deductible only by the person upon whom they are imposed."

The rule that taxes are deductible under the Revenue Acts only by the person upon whom they are imposed has been consistently applied by this Court, by the Circuit Courts of Appeals

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[4] This principle indeed antedated the federal income tax laws, having been adopted by the courts under the Corporation Excise Tax Act of 1909, c. 6, 36 Stat. 11, in denying to national banks deductions of taxes paid by them imposed upon the shareholders' property interest in the banks' shares. *Eliot Nat. Bank* v. *Gill*, 218 Fed. 600 (C. C. A. 1st); *National Bank of Commerce* v. *Allen*, 223 Fed. 472 (C. C. A. 8th); *First Nat. Bank of Jackson, Miss.* v. *M'Neel*, 238 Fed. 559 (C. C. A. 5th).

[5] See *Helvering* v. *Winmill*, 305 U. S. 79, 83:

"Treasury regulations and interpretations long continued without substantial change, applying to unamended or substantially reenacted statutes, are deemed to have received congressional approval and have the effect of law."

and by the Board of Tax Appeals in respect to a wide variety of taxes, and is today undoubted law.*

2. *Whether a particular state tax is imposed upon the taxpayer claiming its deduction is determined by the decisions of the courts of the state which levied the tax*

It is the Government's contention that the Circuit Court of Appeals correctly held that in determining whether the tax here in controversy

* See *United States* v. *Woodward*, 256 U. S. 632 (federal estate tax); *Keith* v. *Johnson*, 271 U. S. 1; *United States* v. *Kombst*, 286 U. S. 424 (state inheritance tax); *Magruder* v. *Supplee*, 316 U. S. 394 (state real property tax); *Helvering* v. *Missouri State Life Ins. Co.*, 78 F. 2d 778 (C. C. A. 8th); *Merchants Bank Bldg. Co.* v. *Helvering*, 84 F. 2d 478 (C. C. A. 8th); *Walsh-McGuire Co.* v. *Commissioner*, 97 F. 2d 983 (C. C. A. 6th); *Lifson* v. *Commissioner*, 98 F. 2d 508 (C. C. A. 8th); *Commissioner* v. *Plestcheeff*, 100 F. 2d 62 (C. C. A. 9th); *Commissioner* v. *Coward*, 110 F. 2d 725 (C. C. A. 3d) (state real property taxes); *Hord* v. *Commissioner*, 95 F. 2d 179 (C. C. A. 6th) (state personal property tax); *Falk Corp.* v. *Commissioner*, 60 F. 2d 204 (C. C. A. 7th); *Eastern Gas & Fuel A.* v. *Commissioner*, 128 F. 2d 369, 375 (C. C. A. 1st) (state income taxes); *Shearer* v. *Commissioner*, 48 F. 2d 552 (C. C. A. 2d) (federal tax on sale of motor vehicle); *Cohan* v. *Commissioner*, 11 B. T. A. 743, 760; *Eisenberg* v. *Commissioner*, 11 B. T. A. 574 (federal tax on sale of specified commodities); *Perry* v. *Commissioner*, 32 B. T. A. 513 (federal gift tax); *Small* v. *Commissioner*, 27 B. T. A. 1219; *Security First Nat. Bank of Los Angeles* v. *Commissioner*, 36 B. T. A. 72; *Gatens Investment Co.* v. *Commissioner*, 36 B. T. A. 309; *Kohlsaat* v. *Commissioner*, 40 B. T. A. 528, 535 (state property taxes); *Eckstein* v. *Commissioner*, 41 B. T. A. 746 (state sales tax).

was imposed upon the corporation or its stockholders, the decisions of the Wisconsin Supreme Court construing its own statute were controlling. It has uniformly been held by this Court, by the Circuit Courts of Appeals and by the Treasury Department that the determination whether a state tax for purposes of deduction under the law is "imposed" upon the taxpayer or upon another is dependent upon state law as interpreted by the highest courts of the state.

In *Keith* v. *Johnson,* 271 U. S. 1, this Court, in deciding that the estate of a decedent was entitled to a deduction in its federal income tax return for the New York transfer taxes paid by it, held itself governed by the last decision of the New York court holding that the transfer tax was "imposed" upon the estate. It said (p. 8):

> This court will follow the decisions of the state courts as to the meaning and proper application of the state transfer tax law, any expressions in its earlier decision [i. e., of the state court] to the contrary notwithstanding.

In *United States* v. *Kombst,* 286 U. S. 424, the Court took the same view in deciding a comparable problem. Section 203 of the Revenue Act of 1916, relating to the federal estate tax, permitted deductions from gross estate of "such other charges against the estate, as are allowed by the laws of the jurisdiction * * * under which the estate is being administered; * * *." The Court had previously determined in *New York*

Trust Co. v. *Eisner,* 256 U. S. 345, that a succession tax, imposed upon the recipients of the estate, as contrasted with an estate tax, imposed on the estate, was not a deductible charge. In determining whether the California tax was a nondeductible succession tax, or a deductible estate tax, this Court followed the California decisions, saying (286 U. S., at 426), "Whether the California tax was a succession or an estate tax is to be determined by reference to the decisions of its highest court."

The Court adhered to the same criterion in the recent case of *Magruder* v. *Supplee, supra,* which involved the right of a purchaser of Baltimore real estate to deduct under Section 23 (c) of the Revenue Act of 1936, state and city real property taxes paid by him. In determining the person upon whom such taxes were imposed the Court was guided by the state law. "Resort must be had here to the laws of Maryland and of the City of Baltimore to determine upon whom the state and city real estate taxes were imposed." (P. 396.)[7]

The principle thus declared by this Court has been uniformly adhered to by the Circuit Courts

[7] See also *Fed. Land Bank* v. *Bismarck Co.*, 314 U. S. 95, in which the Court held that a state sales tax could not be applied to sales of commodities to a federal land bank, since under the state decisions the tax was imposed upon the purchaser. "These determinations of the incidence of the tax by the state court are controlling, and respondents concede the point." (P. 99.)

of Appeals and by the Board of Tax Appeals. In determining whether real and personal property taxes are imposed upon the taxpayer who claims the deduction or upon a predecessor in title, resort must be had to the state laws as interpreted by the courts of that state.[8] The same is true as to state taxes on shares of national and state banks, even though the tax be actually paid by the bank.[9] Whether a state sales tax is imposed upon the buyer or the seller must also manifestly be determined by resort to state law.[10]

3. *The Wisconsin privilege dividend tax by its express terms, and as construed by the Wisconsin Supreme Court, is imposed upon the shareholders of the corporation and not upon the corporation itself*

It is submitted that the Wisconsin statute (Appendix, *infra*, pp. 39–41), providing for the

[8] *Hord* v. *Commissioner*, 95 F. 2d 179 (C. C. A. 6th); *Walsh-McGuire Co.* v. *Commissioner*, 97 F. 2d 983 (C. C. A. 6th); *Lifson* v. *Commissioner*, 98 F. 2d 508 (C. C. A. 8th); *Commissioner* v. *Coward*, 110 F. 2d 725 (C. C. A. 3d); *Commissioner* v. *Plestcheeff*, 100 F. 2d 62 (C. C. A. 9th); *Commissioner* v. *Rust's Estate*, 116 F. 2d 636 (C. C. A. 4th); *Small* v. *Commissioner*, 27 B. T. A. 1219; *Security First Nat. Bank of Los Angeles* v. *Commissioner*, 36 B. T. A. 72; *Kohlsaat* v. *Commissioner*, 40 B. T. A. 528; *Gatens Investment Co.* v. *Commissioner*, 36 B. T. A. 309.

[9] *Porter* v. *United States*, 27 F. 2d 882 (C. C. A. 9th); *Ferguson* v. *Fidelity Union Trust Co.*, 24 F. 2d 520 (C. C. A. 3d); *American National Bank of St. Paul* v. *Commissioner*, 14 B. T. A. 476.

[10] *Eckstein* v. *Commissioner*, 41 B. T. A. 746, 752; 5 Mertens, Law of Federal Income Taxation (1942) 43; *Alabama* v. *King & Boozer*, 314 U. S. 1, 9–10.

privilege dividend tax here in issue, clearly indicates that the tax is upon the shareholders of the corporation and not upon the corporation itself. The first subsection of the statute provides:

> (1) For the privilege of declaring and receiving dividends, out of income derived from property located and business transacted in this state, there is hereby imposed a tax equal to two and one-half per centum of the amount of such dividends declared * * * *and* paid by all corporations * * *. [Italics supplied.]

The last sentence of the subsection is significant:

> Such tax shall be *deducted and withheld* from such dividends payable to residents and nonresidents by the payor corporation. [Italics supplied.]

This provision, that the tax shall be deducted and withheld from the dividends, is repeated in subsections (2) and (3) of the statute:

> (2) Every corporation required to deduct and withhold any tax under this section shall, on or before the last day of the month following the payment of the dividend, make return thereof and pay the tax to the tax commission, * * *.
>
> (3) Every such corporation hereby made liable for such tax, shall deduct the amount

of such tax from the dividends so declared."

It will be noticed that the tax is not only on the privilege of declaring dividends but also on receiving them. While it is true that the corporation pays and is made liable to the state for the tax, nevertheless such payment is not in satisfaction of its own liability, but as a withholding agent of the shareholder. This clearly appears from the statutory requirement that the tax "be deducted and withheld." The tax comes out of the dividends receivable by the shareholders and is thus imposed upon them and paid with their funds. If the tax were against the corporation, as the taxpayer contends, there would be no reason whatever for providing that it be deducted from the dividend declared to the shareholders.

That the tax is laid by the statute on the shareholders is, of course, entirely consistent with the statutory responsibiliy of the corporation for withholding and paying to the state the amounts due. Provisions of a similar character are common in both federal and state revenue laws, and in none of them does the personal liability of the withholding agent establish that the tax in ques-

[11] The remaining subsections of the statute relate to the method of determining the portion of the corporation's income derived from property located and business conducted in the state and to administrative provisions, none of which is material to the question here at issue.

tion is "imposed" on it.[12] Compare *Allen* v. *Regents of the University System of Georgia*, 304 U. S. 439. An example close to the present case is that of state taxes on shares of stock in national banks, for which the bank alone may be made liable to the state for the tax. Both under the corporation excise tax of 1909 and under the federal income tax laws prior to their amendment in 1921, it was held that the banks could take no deduction for the taxes paid by them since the tax was not imposed upon them but on the shareholders.[13]

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[12] A conspicuous example is the Current Tax Payment Act of 1943, P. L. 68, 78th Cong., 1st Sess., Sec. 2, adding to the Internal Revenue Code, Secs. 1622 and 1623, which require employers to deduct and pay from the wages and salaries of the employees a given percentage of the federal income tax. Another example long present in the Federal Revenue Acts concerns the withholding and payment of income taxes upon nonresident aliens on account of income derived from sources within this country. Sec. 221 (a), Revenue Act of 1918, c. 18, 40 Stat. 1057; Sec. 143 (b) and (c), Internal Revenue Code. Likewise, corporations which issue bonds containing a covenant by the obligor to pay the federal income taxes of the obligee on the interest received from those bonds are required to deduct and pay to the Federal Government a tax equal to two percent of the interest. Sec. 221 (b), Revenue Act of 1918; Sec. 143 (a), Internal Revenue Code. It is expressly provided in Section 1622 (c), added by the Current Tax Payment Act, and in Section 143 (a) (3) of the Internal Revenue Code, that the withholding agent is entitled to no deduction for the taxes withheld and paid by it.

[13] *Eliot Nat. Bank* v. *Gill*, 218 Fed. 600 (C. C. A. 1st); *National Bank of Commerce* v. *Allen*, 223 Fed. 472 (C. C. A.

The Bureau of Internal Revenue ruled specifically on the question here at issue in 1936, soon after the passage of the Wisconsin statute. It concluded that the Wisconsin tax is imposed on the shareholders, and may be deducted by them, not by the corporation, in making federal income tax returns. In I. T. 3002, XV-2 Cum. Bull. 142-143 (1936), *infra*, pp. 42-43, the Income Tax Division stated:

> The title of the law and its provisions show that it was the intention of the State legislature to levy an excise tax on the receipt of dividends and to make the corporation declaring and paying the dividend the collector of the tax for and on behalf of the State by requiring the corporation to withhold the tax from the stockholder and to pay the amount withheld to the State tax commission, which in turn pays it into the State treasury.
>
> * * * * *
>
> It is held that the privilege dividend tax is an excise tax imposed upon the stockholder receiving the dividend, who may deduct the amount of the tax in his Federal income tax return. * * *

This is the construction placed upon the statute by the Wisconsin Supreme Court in applying the

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8th); *First Nat. Bank of Jackson, Miss.* v. *M'Neel*, 238 Fed. 559 (C. C. A. 5th); *Porter* v. *United States*, 27 F. 2d 882 (C. C. A. 9th); *American National Bank of St. Paul* v. *Commissioner*, 14 B. T. A. 476.

Wisconsin income tax law. *Wisconsin Gas & E. Co.* v. *Wisc. Dep't of Taxation*, 243 Wis. 216, 10 N. W. (2d) 140; *Blied* v. *Wisconsin Foundry & Machine Co.*, 243 Wis. 221.[11] From these decisions it is clear that the Wisconsin court considers the privilege dividend tax as a tax imposed on the shareholders and not upon the corporation. The first of these cases involved the deductibility as taxes, under the Wisconsin income tax statute, of Wisconsin privilege dividend taxes withheld and paid by the very taxpayer who is petitioner in the present case. The Wisconsin income tax law (Wisconsin Statutes (1935), Sec. 71.03 (4), Appendix, *infra*, pp. 41–42), allowed a deduction from gross income of "taxes * * * paid during the year upon the business or property from which the income taxed is derived, * * *." In that case, as in this, the taxpayer contended that the tax was imposed upon the corporation and not on the shareholders. In that case, as in this, the taxpayer relied upon the decision of this Court in *Wisconsin* v. *J. C. Penney Co.*, 311 U. S. 435. The Wisconsin court approached the problem in a manner fully in accord with the opinions of this Court in *Keith*

[11] The contention of the taxpayer that this Court in *Wisconsin* v. *J. C. Penney Co.*, 311 U. S. 435, held to the contrary, rests, it is submitted, on an erroneous assumption of what the *Penney* case actually decided. The Wisconsin cases cited were decided after the *Penney* case, and with full consideration of its relevance. The *Penney* case is discussed in Point 4 of this brief, *infra*, pp. 23–27.

v. *Johnson, supra; United States* v. *Kombst, supra,* and *Magruder* v. *Supplee, supra.* It said (10 N. W. (2d), at 141):

> The real question in this case is: on whom is the actual burden of this tax laid? This question can have but one answer. *The statute specifically puts it upon the stockholder.* [Italics supplied.]

After pointing out that the *power* of the state to pass the tax in question had been authoritatively determined by this Court in the *Penney* case, *supra,* it said:

> We are certain of three things: (1) that the burden of the tax is specifically laid upon the stockholder; (2) that the corporation declaring the dividend must deduct the tax from the dividend and may not under any circumstances treat the tax as a necessary expense of doing business; (3) that the power to levy the tax so construed was authoritatively established in the *Penney* case.

It therefore concluded that under the Wisconsin statute no deduction could be taken from the tax in question.

Blied v. *Wisconsin Foundry & Machine Co., supra,* was an action by a preferred stockholder in a Wisconsin corporation against the corporation to recover the privilege dividend tax deducted and withheld from the preferred dividend declared by the defendant corporation. The court affirmed the decision of the lower court sustain-

ing a demurrer to the complaint. The plaintiff admitted that the language of the statute seemed to place the tax on the stockholder, but contended that such language should be ignored in view of the fact that the corporation alone was made liable for the tax and that no personal liability was imposed upon the stockholder. The apparent contention was that if the tax were against the corporation it would be illegal to deduct the tax from the dividends to which the shareholder was entitled by his contract with the corporation. The Supreme Court affirmed the court below on the grounds set forth in its opinion in the *Wisconsin Gas & Electric Co.* case decided the same day.

These decisions of the Wisconsin Supreme Court are, it is submitted, under the authority of the decisions of this Court in *Keith* v. *Johnson, supra, United States* v. *Kombst, supra,* and *Magruder* v. *Supplee, supra,* controlling on the issue here presented.

It may be admitted, as petitioner argues (Br. 15–17), that the deductibility of taxes under a state revenue act is not necessarily determinative of deductibility under the federal law. The Commissioner does not contend to the contrary. The important point is not merely that the tax is not deductible by the corporation under the Wisconsin income tax law, but that the Wisconsin Supreme Court in the cases cited determined that the tax was not upon the corporation but upon the shareholders. In determining the person who is entitled

to deductions of taxes under the Wisconsin statute it appears that the same criteria are applied as in the case of deductions of taxes under the federal statute. The Wisconsin court pointed out that the controlling question was: "Whether this is a tax upon the corporation, in which case it is assumed that it must be regarded as an expense of doing business deductible from gross income, or whether it is a tax upon the stockholders." (243 Wis. at —.) This is merely to state in another form the federal requirement that taxes in order to be deductible must be "imposed" upon the taxpayer claiming their deduction. In deciding that the corporation paying the tax was not entitled to its deduction under the Wisconsin income tax law, the Wisconsin court necessarily held that the tax was not "upon the corporation" or, in the terminology of federal law, was not "imposed" upon it. That determination should, under accepted principles, be followed here, and the tax be held not deductible under the federal act.[15]

It is of no significance that the Wisconsin court used the term "burden" in stating that "the burden of the tax is specifically laid upon the stockholder." The statement itself, no less than the opinion as

[15] In this respect the present case is analogous to *Keith* v. *Johnson*, *supra*, in which this Court, in applying the federal income tax statute, followed the decision of the New York court holding that, as the New York transfer tax was imposed upon the estate of the decedent, it was a deductible tax for purposes of the state income tax on the estate.

a whole, shows that the term was used as a synonym for the legal incidence of the tax, and not to describe merely its ultimate or transferred economic impact. Cf. *Colorado National Bank* v. *Bedford*, 310 U. S. 41, 52–53; *National Bank of Commerce* v. *Allen*, 223 Fed. 472 (C. C. A. 8). It is clear from the decision itself that the court's holding did not turn on any inquiry as to the person upon whom the economic burden of the tax ultimately rested. The case involved appeals by four corporations. One of these corporations, the Wisconsin-Michigan Power Company, instead of deducting the tax from the dividends paid the shareholders, absorbed the tax itself so that the economic burden thereof was borne by the corporation and not by the stockholders. Nevertheless, the Wisconsin court held that the corporation, like the corporations which passed on the burden of the tax to the shareholders, was not entitled under the Wisconsin statute to the deduction of the tax. The Wisconsin income tax law, in allowing deductions for taxes, like the federal law, does not concern itself with the person upon whom the economic burden of the tax ultimately rests. Both under Section 71.03 (4) of the Wisconsin statute and under Section 23 (c) of the Federal Revenue Act, the deduction of the tax is confined to those persons upon whom the tax is in law assessed or imposed. That the Wisconsin court was fully cognizant of the distinction between the two concepts is shown by its original opinion in *State*

ex rel. Froediert G. & M. Co. v. *Tax Comm.*, 221 Wis. 225, 243, upholding the constitutionality of the Wisconsin tax, where the court specifically stated that it was entirely immaterial "upon whom the burden of it [the tax] ultimately falls."[16]

It is submitted that Wisconsin privilege dividend taxes are, both by the wording of the statute which imposes them and by the decisions of the Wisconsin Supreme Court interpreting the statute, clearly not imposed upon the corporation. Hence they are not deductible by the corporation under the Revenue Act as "taxes paid or accrued."

If, however, contrary to the Commission's contention, this Court should deem that the Wisconsin statute or decisions are not clear on the issue here involved, this question, involving as it

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[16] The complete quotation from the court's opinion is as follows (p. 243):

"* * * If the tax is an excise tax, and we hold that it is, it is entirely immaterial upon whom the burden of it ultimately falls. In a sales tax it falls usually as least upon the purchaser. In a stamp tax on deeds it usually falls on the seller. In an inheritance tax it falls on the recipient of the property. In the stock transfer tax above referred to it probably fell on the broker consummating the transfer. In a stamp tax on checks it falls on the drawer of the check. In none of the cases is it a personal property tax against the person upon whom the burden of it ultimately falls."

The court also took pains to point out: "we did not in the original opinion take the position that the tax is necessarily one against the corporation." In none of its later decisions has the court receded from this position.

does a matter of a local statute, is of the kind which this Court has suggested may ordinarily be left to the Circuit Court of Appeals which is more conversant with the local law. See *Helvering* v. *Stuart*, 317 U. S. 154, 162–163.

4. *The decisions of this court in Wisconsin* v. *J. C. Penney Co. and Biddle* v. *Commissioner are not applicable to the present case*

The contention that this Court in *Wisconsin* v. *J. C. Penney Co.*, 311 U. S. 435, held that the Wisconsin privilege dividend tax was assessed against the corporation on its Wisconsin earnings and that the holding is conclusive of the question here presented rests, it is submitted, on a misconception of what this Court actually decided in that case. That case involved only the *power* of the State of Wisconsin to levy the tax in question. As the Government understands that decision, this Court, in describing the "practical operation of this legislation" as the levy of "an additional tax on corporate earnings within Wisconsin" (311 U. S. at 442), did not undertake to determine that as between corporation and shareholders the legal incidence of the tax was on the former. The Court reasoned that since the State of Wisconsin would have had the power to levy a tax upon such earnings, and since the tax in question was confined to such earnings, it came within that constitutional power of the

state, even though the tax itself was denominated one "For the privilege of declaring and receiving dividends" and had thus been characterized by the supreme court of the state. In thus upholding the tax in question, this Court acted on well recognized principles. The criterion for determining the power of a state to levy taxes is, as this Court stated (311 U. S. at p. 444):

> whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return.

In that case this Court found such protection, opportunity and benefits in the grant of the "substantial privilege of carrying on business in Wisconsin." (Pp. 444–445.) The "descriptive pigeonhole" into which the state court put the tax was entirely immaterial. The decision, therefore, simply stands for the proposition that the state's power to tax depends upon the "benefit and protection conferred by the taxing sovereignty" in respect to the tax in question. *Curry* v. *McCanless*, 307 U. S. 357, 368. The answer to this constitutional question is not dependent upon the particular form which the tax in question may take.[17]

That this is all that the Court decided in the *Penney* case is shown by its reference (pp. 443–

[17] See *Helvering* v. *Bullard*, 303 U. S. 297, 301.

444) to *Henderson* v. *Mayor of N. Y.*, 92 U. S. 259, and to *Lawrence* v. *State Tax Comm.*, 286 U. S. 276, 280. The first of these cases held unconstitutional a New York statute because its practical effect was to impose a tax on foreign commerce, though the statute in question was phrased in the language of a police measure. The second upheld a state income tax on the out-of-state earnings of a state resident since the Court found, as far as the question of power to tax was concerned, no distinction between such a tax and a state property tax on the intangibles of its citizens, wherever the intangibles might be considered to be located.

The grounds upon which this Court relied in sustaining the validity of the Wisconsin tax have not led the Supreme Court of Wisconsin to hold that the tax in question is a tax upon the corporation. On remand of the *Penney* case, that court adhered to the position that the tax is a tax "on the privilege of declaring and receiving a dividend", and in "no sense and to no extent whatever, is it a tax upon the income of the corporation." *J. C. Penney Co.* v. *Tax Comm.*, 238 Wis. 69, 73. The Wisconsin court later said in *International H. Co.* v. *Wisconsin Dept. of Taxation*, 243 Wis. 198, 10 N. W. (2d) 169, 172: "As we read the opinion of the United States Supreme Court, we discover no attempt by the court to usurp the function of this court so far as construing or labeling this tax is concerned." The court, correctly in

our view, construed the opinion of this Court in the *Penney* case as merely ascertaining the "factual basis" upon which the validity of the Wisconsin tax depended. Moreover, as has been shown, the Wisconsin court in *Wisconsin Gas & E. Co.* v. *Wisc. Dept. of Taxation, supra,* upon full consideration of the *Penney* case, specifically held that the Wisconsin privilege dividend tax is imposed on the stockholders and not upon the corporation." The taxpayer in relying upon the Wisconsin decisions that this is a tax on the privilege of declaring and receiving dividends,

[18] The contrary opinion of the district court in the present case (R. 6–8), and the opinion of the Tax Court in *Montreal Mining Co.* v. *Commissioner*, 2 T. C. 688, both of which rely upon the decision of this Court in the *Penney* case, are not persuasive. The opinion of the district court was promulgated prior to the decision of the Wisconsin court in the *Wisconsin Gas & Electric Co.* case. Although the opinion of the Tax Court was published after that decision, the case was submitted and briefed prior thereto, and the Tax Court makes no reference to it. The decision of the Tax Court does not rest upon its independent determination of the issue presented, but upon the assumed authority of the *Penney* case. Cf. *Commissioner* v. *Heininger*, No. 63, present Term, decided December 20, 1943. Moreover, this is not a field in which the Tax Court's experience and special qualifications entitle its decisions to more weight than the judgments of other qualified tribunals. The ultimate question is one of statutory construction and even where the meaning of a federal statute is involved the Tax Court's decisions are specifically made reviewable. H. Rep. No. 1, 69th Cong., 1st Sess., pp. 19–20 (1939–1 Cum. Bull. (Part 2) 315, 328); S. Rep. No. 52, 69th Cong., 1st Sess., p. 36 (1939–1 Cum. Bull. (Part 2) 332, 359). *The Security Flour Mills* v. *Commissioner*, No. 276, present Term, decided February 28, 1944.

cannot ignore the correlative holding that the tax is on the shareholders and not on the corporation.

Acceptance by this Court of the Wisconsin court's characterization of the tax as one imposed upon the shareholders will not affect the previous decision of this Court that the tax is within the constitutional power of the state. Whether the tax be regarded as imposed upon the corporation or upon the shareholders, the source of the tax is the earnings of a corporation in Wisconsin. Since such earnings depend upon the privilege granted to the corporation by the State of Wisconsin, the constitutional power of the state to levy the tax is clear. This is particularly true of the present case, where the corporation is one created by the State of Wisconsin, and where it has not been found that any of the shareholders were nonresidents of the state (see opinion of the Circuit Court of Appeals, R. 23). But in any event, since the corporation here involved was a Wisconsin corporation, the power of the state to tax the interest of the shareholders, whether by a property tax or by a tax on the receipt of dividends, is incontrovertible. See *Corry* v. *Baltimore*, 196 U. S. 466; *Schuylkill Trust Co.* v. *Penna.*, 302 U. S. 506, 514; *Lawrence* v. *State Tax Comm.*, 286 U. S. 276.

The decision below also is not opposed to the decision of this Court in *Biddle* v. *Commissioner*, 302 U. S. 573, relied upon by the taxpayer. That

case concerned the right of a taxpayer to a credit for "the amount of any income * * * taxes paid or accrued during the taxable year to any foreign country" as provided in Section 131 (a) (1) of the Revenue Act of 1928, as well as the alternative claim of the taxpayer for deduction of "taxes paid or accrued" under Section 23 (c) of the same Act. The taxpayer claimed under those sections an allowance of certain taxes asserted to constitute "income taxes" imposed upon her under the British income tax act. The British law imposed a standard or normal income tax on the corporation. It imposed a surtax on the shareholders, which was measured not only by the dividends paid to the shareholder but by an additional amount, called a tax "appropriate to" the dividend, computed at the normal rate. The surtax paid by the shareholders was concededly allowable as a credit and deduction under the Federal revenue act. The question related solely to the tax "appropriate to" the dividend, which was not a tax paid either by the shareholders or by the corporation on their behalf save as the ordinary corporate income tax payable for the year in which the corporate income was earned may have corresponded to the item in question. In including this item in the surtax base for the shareholders, and in giving them in certain circumstances a right of refund with respect to the ordinary corporate tax, the British law to that extent treated the corporation and its

shareholders as a single entity. As this Court explained, that treatment was in recognition of the conception that the stockholders in any event bear the economic burden of the corporate tax. See 302 U. S., p. 581. "Our revenue laws," this Court added, "give no recognition to that conception" (*Ibid.*). Consequently the tax "appropriate to" the dividends could not be regarded for purposes of our revenue act as a tax imposed on the shareholders.

That case furnishes no basis for disregarding the nature of the tax here involved, as established by the decisions of the Wisconsin court. In the *Biddle* case the only taxes paid to the Crown were the normal corporate income tax and the individual surtax, and for the latter the shareholders received credit under our law. The present case involves a transaction whereby the corporation is required to deduct from dividends otherwise due to the shareholders an amount to be paid over to the public treasury, in addition to the ordinary corporate income tax whose economic burden is borne by the shareholders and which alone was involved in the *Biddle* case. The *Biddle* case was concerned with a claimed credit based on a system of corporate taxation wholly foreign to our own; the present case involves a system which is by no means unfamiliar, which has been authoritatively explained by the state court, and by which there is imposed upon one

class of taxpayers a tax which is collected by requiring the taxpayers' obligors to withhold the tax and themselves pay it to the Government.

The phrase in the *Biddle* opinion that our law does not treat "as taxpayers those upon whom no legal duty to pay the tax is laid" (p. 581) cannot be wrenched from the facts in respect of which it was uttered. The federal law frequently treats as taxpayers those upon whom no personal liability for the tax is imposed. Owners of real estate who pay the taxes imposed upon the land are treated as taxpayers and are entitled to deduct such taxes in their federal income tax returns though the tax is solely a lien upon the land and no personal liability to pay it is imposed on anyone. *Commissioner* v. *Coward,* 110 F. 2d 725 (C. C. A. 3d). Also, the Federal Government treats as taxpayers citizens of foreign countries residing abroad, where their income is attributable to sources in this country, even though for obvious reasons no personal duty to pay the tax is imposed upon them. See Sec. 143 (b) and (c), Internal Revenue Code; *Sabatini* v. *Commissioner,* 98 F. 2d 753 (C. C. A. 2d). And in deciding whether state taxes on services rendered or on goods sold place an unconstitutional exaction on federal agencies, this Court does not regard as decisive the entity on whom the duty rests to make the actual payment to the state. *Colorado Bank* v. *Bedford,* 310 U. S. 41; *Fed. Land Bank* v. *Bismarck Co.,* 314 U. S. 95. In any event, the Wisconsin privilege

dividend tax, since it is required to be withheld and deducted from the dividend payable to the shareholders, is not only imposed upon them, but collected from their funds. It is their tax and not a tax of the corporation.

II

THE TAXPAYER IS NOT ENTITLED UNDER SECTION 23 (d) OF THE REVENUE ACT OF 1934 TO A DEDUCTION OF THE WISCONSIN PRIVILEGE DIVIDEND TAX

Petitioner raises the question whether, assuming that the Wisconsin privilege dividend tax is imposed upon the shareholders, the corporation paying it is nevertheless entitled to a deduction of tax under Section 23 (d) of the Revenue Act of 1934. That section provides (Appendix A, *infra*, p. 38):

> The deduction for taxes allowed by subsection (c) shall be allowed to a corporation in the case of taxes imposed upon a shareholder of the corporation upon his interest as shareholder which are paid by the corporation without reimbursement from the shareholder, * * *.

It is submitted that this section has no application to the Wisconsin privilege dividend tax, in the light of its clear wording, its legislative history, and the construction uniformly given to it by the Treasury Regulations. The inapplicability of the section rests on the fact (a) that the present tax is not on the "interest" of the shareholders as

such, and (b) that the corporation in substance receives "reimbursement" from the shareholders by deducting the amount of the tax from the dividends paid. Either ground requires the conclusion that section 23 (d) has no application.

A. The deduction is restricted by the words of the statute to "taxes imposed upon a shareholder of the corporation upon his *interest* as shareholder." (Italics supplied.) This, it is submitted, refers to property taxes upon the shares of stock imposed upon the shareholders and not to an excise tax in respect of dividends, such as the present tax is declared to be. But even though the statute be considered ambiguous, the doubt must be resolved in favor of the Government since the section in question is an allowance of a deduction. "The rule that ambiguities in statutes imposing taxes are to be resolved in favor of taxpayers does not apply. Deductions are allowed only when plainly authorized." *Helvering* v. *Inter-Mountain Life Insurance Co.*, 294 U. S. 686, 689. This provision was first enacted by Section 234 (a) of the Revenue Act of 1921 and has remained in substantially the same form down to and including Section 23 (d) of the Internal Revenue Code. The occasion and purpose of the enactment are quite clear. It will be recalled that prior to this statute it had been held that national and other banks were not entitled to a deduction for state taxes upon the shares of stock in those

banks even though the tax was collected from and paid by the bank. *Eliot Nat. Bank* v. *Gill,* 218 Fed. 600 (C. C. A. 1st); *National Bank of Commerce* v. *Allen,* 223 Fed. 472 (C. C. A. 8th); *First Nat. Bank of Jackson, Miss.* v. *M'Neel,* 238 Fed. 559 (C. C. A. 5th); *Porter* v. *United States,* 27 F. 2d 882 (C. C. A. 9th); *American National Bank of St. Paul* v. *Commissioner,* 14 B. T. A. 476. The provision here in question was obviously intended by Congress to allow the banks to take the deduction denied them by these cases. The provision was introduced into the federal revenue laws by a Senate amendment to the Revenue Bill for 1921. In the Hearings before the Committee on Finance of the United States Senate, 67th Cong., 1st Sess., pp. 250–251, Dr. T. S. Adams, Technical Advisor to the Treasury, made the following statement:

> Now, Senator Smoot, reverting to your proposition, the Bankers' Association are asking that they be allowed to claim deduction for State and local property taxes which they pay. The banks pay these taxes for and on behalf of their stockholders. The taxes, you will remember, are on the stockholders. The bank voluntarily assumes it and pays it. The banks now want to claim a deduction for it. They do it almost universally.

This amendment was adopted by the Committee and thus found its way into the Revenue Act.

While the Senate Committee Report on that Bill is phrased in language broad enough to include the deduction of all taxes on shareholders paid by the corporation,[19] it is submitted that the amendment confining the deduction to taxes "imposed upon a shareholder of the corporation upon his interest as shareholder" is limited to taxes upon the shares as property and does not include the tax here in question.

This is the uniform construction given to the statute by the Treasury Regulations. Treasury Regulations 62, promulgated under the Revenue Act of 1921, provided in Article 566:

> Under the Revenue Act of 1921 banks or other corporations paying taxes assessed against their stockholders *on account of their ownership of the shares of stock issued by such corporations,* without reimbursement from such shareholder or member, may deduct the amount of taxes so paid. [Italics supplied.]

This regulation is identical with Article 23 (d)–1 of Regulations 86 (Appendix A, *infra,* p. 39), promulgated under the Revenue Act of 1934, applica-

[19] S. Rep. No. 275, 67th Cong., 1st Sess., p. 19 (1939–1 Cum. Bull. (Part 2) 181, 194):

"Section 234 authorizes corporations to take deductions similar to those accorded individuals by the terms of section 214, with the following provisions applicable only to corporations: (1) Corporations (particularly banks) are permitted to deduct certain taxes paid by them for or on behalf of their shareholders or members; * * *."

ble to the present case. It is contained in identical form in all the Regulations promulgated since the section was first introduced into the Act. See Regulations 111, promulgated under the Internal Revenue Code, Sec. 29.23 (d)–1. This regulation clearly confines the deduction to taxes assessed against shareholders on account of their ownership of the shares of stock, and is entitled to the effect of law. See *Helvering* v. *Winmill*, 305 U. S. 79, 83.

The only attempt by a corporation to extend this deduction to taxes other than those imposed on stock as property, so far as our research has discovered, was in *Eastern Gas & Fuel A.* v. *Commissioner*, 128 F. 2d 369 (C. C. A. 1st). In that case the taxpayer association, a so-called Massachusetts trust, had agreed in its declaration of trust to pay the Massachusetts income taxes levied on its members on account of dividends declared by the association. The court denied that the association was entitled to a deduction for such taxes under Section 23 (d), saying (p. 375):

> Section 23 (d) allows a deduction to a corporation in the case of taxes "imposed upon a shareholder of the corporation *upon his interest as shareholder* which are paid by the corporation without reimbursement from the shareholder * * *." (Italics supplied.) It is clear from the regulations that the use of the term "interest"

> relates to a tax upon the ownership of stock and not to the income derived therefrom. Art. 23 (d), Regulations 86, 1934; 3 Paul & Mertens, *supra,* Secs. 25.28, 25.30. We are satisfied that this is the correct interpretation of Section 23 (d). * * *

B. Moreover, and perhaps of greater importance, Section 23 (d) of the Revenue Act confines the corporation's deductions to taxes paid by it on behalf of its shareholders "without reimbursement from the shareholder." The obvious purpose of the provision is to confine the deduction to taxes the burden of which is borne by the corporation.

The taxpayer in the instant case has not shown that it bore the burden of the tax, and since the tax was assessed in accordance with the Wisconsin statute (R. 5), it must be assumed that the provisions of that statute were followed and that the tax was in fact withheld from the dividends paid. Such deduction was in effect a "reimbursement" of the corporation for the tax paid, though it occurred through the medium of a withholding of the tax from the amounts due the shareholders, instead of through the more circuitous method of a payment by the corporation to the shareholders of the entire dividend and a repayment by them of the tax paid by the corporation. The specific purpose of the statutory qualification of the right to deduct taxes is clear, and its operation will not be

avoided because the corporation was reimbursed by a direct instead of an indirect method.[20]

CONCLUSION

The decision of the Circuit Court of Appeals is correct and should be affirmed.

Respectfully submitted.

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MARCH 1944.

[20] Cf. *Harrison* v. *Northern Trust Co.*, 317 U. S. 476. There this Court held that residuary bequests to charities were not deductible from the federal estate tax to the extent of the entire amount of the residue, but only on that amount with the federal estate tax deducted therefrom. In so holding the Court refused to give a literal construction to the words taxes "payable * * * out of the bequests" in Section 807 of the Revenue Act of 1932, relying on the purpose of Congress as disclosed in the legislative history of the Act to disallow taxes which in fact reduced the charitable bequests.

APPENDIX A

Revenue Act of 1934, c. 277, 48 Stat. 680:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (c) *Taxes Generally.*—Taxes paid or accrued within the taxable year, except—[exceptions not pertinent to the instant case]
>
> * * * * *
>
> (d) *Taxes of Shareholder Paid by Corporation.*—The deduction for taxes allowed by subsection (c) shall be allowed to a corporation in the case of taxes imposed upon a shareholder of the corporation upon his interest as shareholder which are paid by the corporation without reimbursement from the shareholder, but in such cases no deduction shall be allowed the shareholder for the amount of such taxes.

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

> ART. 23 (c)–1. *Taxes.*—Subject to the exceptions stated in this article and articles 23 (c)–2 and 23 (c)–3, taxes imposed by the United States, any State or Territory, or political subdivision of either, possessions of the United States, or foreign countries, are deductible from gross income for the year in which paid or accrued (see section 43). Estate, inheritance, legacy, succession, and gift taxes and Federal income, war-profits, and excess-profits taxes are not deductible.

from gross income. Income, war-profits, and excess-profits taxes imposed by the authority of any foreign country or possession of the United States are deductible from gross income in cases where the taxpayer does not signify in his return his desire to have to any extent the benefits of section 131 (relating to credit for taxes of foreign countries or possessions of the United States). See generally articles 131–1 to 131–8 as to tax credits. Postage is not a tax. Amounts paid to States or Territories under secured debts laws in order to render securities tax exempt are deductible. Automobile license fees are ordinarily taxes. In general taxes are deductible only by the person upon whom they are imposed. As to tax paid at the source on interest from tax-free covenant bonds, see section 143 (a) (3).

ART. 23 (d)–1. [as amended by T. D. 4585, XIV–2 Cum. Bull. 54 (1935)] *Tax on bank or other stock.*—Banks or other corporations paying taxes assessed against their shareholders on account of their ownership of the shares of stock issued by such corporations without reimbursement from such shareholders may deduct the amount of taxes so paid. The Act specifically provides, however, that in such cases the shareholders may not deduct the amount of the taxes. The amount so paid should not be included in the income of the shareholder.

Laws of Wisconsin (1935), c. 505:

SEC. 3. *Privilege dividend tax.* [as amended by Laws of Wisconsin (1935), c. 552, Sec. 1] (1) For the privilege of declaring and receiving dividends, out of income derived from property located and business transacted in this state, there is

hereby imposed a tax equal to two and one-half per centum of the amount of such dividends declared * * * *and* paid by all corporations (foreign and local) after the passage and publication of this act and prior to July 1, 1937. Such tax shall be deducted and withheld from such dividends payable to residents and nonresidents by the payor corporation.

(2) Every corporation required to deduct and withhold any tax under this section shall, on or before the last day of the month following the payment of the dividend, make return thereof and pay the tax to the tax commission, reporting such tax on the forms to be prescribed by the tax commission.

(3) Every such corporation hereby made liable for such tax, shall deduct the amount of such tax from the dividends so declared.

(4) In the case of corporations doing business within * * * *and* without the state of Wisconsin, such tax shall apply only to dividends declared and paid out of income derived from business transacted and property located within the state of Wisconsin. The amount of income attributable to this state shall be computed in accordance with the provisions of chapter 71. In the absence of proof to the contrary, such dividends shall be presumed to have been paid out of earnings of such corporation attributable to Wisconsin under the provisions of chapter 71, for the year immediately preceding the payment of such dividend. If a corporation had a loss for the year prior to the payment of the dividend, the tax commission shall upon application, determine the portion of such dividend paid out of corporate surplus and

undivided profits derived from business transacted and property located within the state.

(5) Dividends paid by a subsidiary corporation to its parent shall not be subject to the tax herein imposed provided that the subsidiary and its parent report their income for taxation under the provisions of chapter 71 on a consolidated income return basis, or both corporations report separately.

(6) The provisions of this section shall not apply to dividends declared and paid by a Wisconsin corporation out of its income which it has reported for taxation under the provisions of chapter 71, * * * *to the extent that* the business of such corporation consists in the receipts of dividends *from which a privilege dividend tax has been deducted and withheld* and the distribution thereof to its stockholders.

(7) For the purposes of this section dividends shall be defined as in section 71.02, except that the tax herein imposed shall not apply to stock dividend or liquidating dividends.

(8) The tax hereby levied, if not paid within the time herein provided, shall become delinquent and when delinquent shall be subject to a penalty of two per cent on the amount of the tax and interest at the rate of one-half per cent per month until paid.

(9) The tax hereby imposed shall, when collected by the tax commission, be paid by it into the state treasury.

The Act was further amended retroactively by Laws of Wisconsin (1937), c. 233, Secs. 1 and 4. The amendments, however, are not pertinent to the present case.

Wisconsin Statutes (1935), c. 71:

71.03 *Deductions from gross income of corporations.*—Every corporation, joint stock company or association shall be allowed to make from its gross income the following deductions:

* * * * *

(4) Taxes other than special improvement taxes paid during the year upon the business or property from which the income taxed is derived, including therein taxes imposed by the state of Wisconsin and the government of the United States as income, excess or war profits and capital stock taxes, including taxes on all real property which is owned and held for business purposes whether income producing or not, provided that such portion of the deduction for federal income and excess profits taxes as may be allowable shall be confined to cash payments made within the year covered by the income tax return, and provided further that deductions for income taxes paid to the United States government shall be limited to taxes paid on net income which is taxable under this chapter; and provided further that income taxes imposed by the state of Wisconsin shall accrue for the purpose of this subsection only in the year in which such taxes are assessed.

APPENDIX B

I. T. 3002, XV–2 Cum. Bull. 142–143 (1936):

Advice is requested whether, for Federal income tax purposes, the corporation paying a dividend or the stockholder receiving it is entitled to deduct the privilege dividend tax of 2½ per cent imposed by the State of Wisconsin under section 3 of chapter 505, Laws of Wisconsin, 1935.

* * * * *

The title of the law and its provisions show that it was the intention of the State legislature to levy an excise tax on the receipt of dividends and to make the corporation declaring and paying the dividend the collector of the tax for and on behalf of the State by requiring the corporation to withhold the tax from the stockholder and to pay the amount withheld to the State tax commission, which in turn pays it into the State treasury.

Section 23 (c) of the Revenue Act of 1934 provides that in computing net income there shall be allowed as deductions taxes paid or accrued within the taxable year, with certain exceptions not here material. Article 23 (c)–1 of Regulations 86, relating to the Revenue Act of 1934, provides that in general taxes are deductible only by the person upon whom they are imposed.

It is held that the privilege dividend tax is an excise tax imposed upon the stockholder receiving the dividend, who may deduct the amount of the tax in his Federal income tax return. The stockholder, however, should report in his return the full amount of the dividend, including the tax withheld.

U. S. GOVERNMENT PRINTING OFFICE: 1944

SUPREME COURT OF THE UNITED STATES.

No. 565.—October Term, 1943.

Wisconsin Gas and Electric Company, Petitioner, vs. The United States of America.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit.

[May 29, 1944.]

Mr. Justice Rutledge delivered the opinion of the Court.

Wisconsin Gas and Electric Company is a Wisconsin corporation engaged in public utility and associated operations wholly within that State. In 1935 it declared a dividend from its public utility earnings, and in accordance with the requirements of Wisconsin's Privilege Dividend Tax Act [Wisconsin Laws of 1935, c. 565, § 3; c. 552], it paid to the State two and one-half per cent of the amount of dividends thus declared. It now claims this sum, $3,750, as a deduction from its gross income for 1935 for federal income tax purposes.

After the claim was disallowed and a deficiency assessed, the company paid the tax and brought this suit for refund under 28 U. S. C. § 41(20). The District Court was of the opinion that the decision in *Wisconsin* v. *J. C. Penney Co.*, 311 U. S. 435, required permitting the deduction under Section 23(c) of the Revenue Act of 1934, 48 Stat. 680, 688. It therefore gave judgment for the company. 46 F. Supp. 929. The Circuit Court of Appeals disagreed on this question and, holding the deficiency correctly determined, reversed the judgment. 138 F. 2d 597. We granted certiorari, 321 U. S. —, because of the claimed conflict with the *Penney* case and the importance of the question in the administration of the revenue laws.

Petitioner's claim for a refund rests on the assertion it was entitled to deduct the Privilege Dividend Tax payments under either Section 23(c) or Section 23(d) of the Revenue Act of 1934, 48 Stat. 680, 688, 689.

Section 23(c) allows a taxpayer to deduct from gross income "taxes paid or accrued within the taxable year." The relevant

Treasury Regulation, which is of long standing,[1] includes among "taxes paid" those imposed by any State, and provides: "In general taxes are deductible only by the person upon whom they are imposed." The question in this branch of the case, therefore, comes down to whether the Privilege Dividend Tax is "imposed" upon the corporation declaring the dividends.

Resolution of that question requires examination of the Wisconsin statute and its application and interpretation by the courts of that State. *Keith* v. *Johnson*, 271 U. S. 1; *United States* v. *Kombst*, 286 U. S. 424; *Magruder* v. *Supplee*, 316 U. S. 394. In 1935 the state Act[2] provided:

(1) For the privilege of declaring and receiving dividends, out of income derived from property located and business transacted in this state, there is hereby imposed a tax equal to two and one-half per centum of the amount of such dividends declared and paid by all corporations (foreign and local) after the passage and publication of this act and prior to July 1, 1937. Such tax shall be deducted and withheld from such dividends payable to residents and nonresidents by the payor corporation.

(2) Every corporation required to deduct and withhold any tax under this section shall, on or before the last day of the month following the payment of the dividend, make return thereof and pay the tax to the tax commission, reporting such tax on the forms to be prescribed by the tax commission.

(3) Every such corporation hereby made liable for such tax, shall deduct the amount of such tax from the dividends so declared.[3]

The tax is aimed at corporate earnings "derived from property located and business transacted in" Wisconsin. Doubtless all taxes on corporate earnings are, to a greater or lesser extent, translated into economic burdens upon the shareholder. And not all such taxes can be said, for that reason, to be "imposed" upon the shareholder. Cf. *Biddle* v. *Commissioner*, 302 U. S. 573. However, here the burden is placed upon him, not derivatively as through an income tax upon the corporation, but directly and

[1] Treasury Regulation 86, Art. 23(e)-(1); cf. Treasury Regulation 65, Art. 131; Treasury Regulation 69, Art. 131; Treasury Regulation 74, Art. 151; Treasury Regulation 77, Art. 151.

[2] Wisconsin Laws of 1935, c. 505, § 3 as amended by Wisconsin Laws of 1935, c. 552. The Act was subsequently amended (Wisconsin Laws of 1937, c. 233; c. 309, § 3; Wisconsin Laws of 1939, c. 198; Wisconsin Laws of 1941, c. 63, § 3; Wisconsin Laws of 1943, c. 367, § 2), but the amendments leave the present question unaffected.

[3] The Act is set out in full in Wisconsin *v.* J. C. Penney Co., 311 U. S. 435, at note 1.

exclusively. While corporate earnings are the target of this tax, its specific thrust, according to the Wisconsin Supreme Court, is at their transfer as dividends to the shareholder, rather than at their receipt as income by the corporation. *J. C. Penney Co.*, v. *Tax Commission*, 238 Wis. 69. It is not imposed until dividends are declared. When imposed it is to be deducted and withheld not from earnings received by the corporation, but "from the dividends so declared." The sums thus paid to the State are to be deducted from the fixed dividends owed to the preferred stockholder who cannot recover his loss from the corporation. *Blied* v. *Wisconsin Foundry & Machine Co.*, 243 Wis. 221. And the corporation which seeks to leave the stockholder's dividend whole by absorbing the tax itself receives no credit therefor under those provisions of the Wisconsin income tax law comparable to Section 23(e), because the State "puts the burden of this tax upon the stockholder and not upon the corporation." *Wisconsin Gas & Electric Co.* v. *Wisconsin Department of Taxation*, 243 Wis. 216.

That Wisconsin has made the corporation its tax collector by requiring it to withhold payment of a portion of the dividends and to turn that portion over to the State does not make the tax one "imposed" upon the corporation, at least under Section 23(e) and the relevant Treasury Regulation. Compare *Eliot National Bank* v. *Gill*, 218 Fed. 600 (C. C. A.); *Porter* v. *United States*, 27 F. 2d 882 (C. C. A.) The fact is that the tax is extracted from fixed dividends owed to the stockholder, not merely from his common interest in corporate earnings. Under Wisconsin decisions the impact of the tax is focused narrowly and falls independently upon each recipient of the dividend without affecting the tax burden of the corporation or other shareholders. The operation thus disclosed for the tax amply sustains the emphatic declaration of the Wisconsin Supreme Court that it is imposed upon the shareholder, not upon the corporation. This view is complemented by the interpretation of the Bureau of Internal Revenue that the tax payments, although formally made by the corporation, are deductible by the shareholder.[4] We conclude that the Privilege Dividend Tax is not "imposed" upon petitioner and therefore payments of it are not deductible under Section 23(e).

There is of course no question in this case that Wisconsin has the power, under the Federal Constitution, to impose this tax.

[4] I. T. 3002, XV-2 Cum. Bull. 142-143 (1936).

That question was involved in *Wisconsin* v. *J. C. Penney Co.*, 311 U. S. 435, where this Court was concerned with dividends declared by a foreign corporation doing a local business in Wisconsin. The decision was that the relationship of the State to the enterprises there shown to have been carried on within its boundaries and under the protection of its police power was such that its taxing power could constitutionally reach earnings derived from those operations, regardless of how the impost was characterized by the State. The State's power to tax earnings of that character is not dependent upon whether the tax is hinged on the receipt of them as corporate income or on the transfer and receipt of them as dividends. Nor does it depend upon whether the tax here involved is "imposed" upon the corporation or upon the stockholder. *International Harvester Co.* v. *Wisconsin Department of Taxation*, No. 620, decided this day; *Minnesota Mining and Manufacturing Co.* v. *Wisconsin Department of Taxation*, No. 621, decided this day. In this case, where the earnings of a Wisconsin corporation doing business solely in Wisconsin are the source of the dividends, the State's power to tax their transfer and impose that tax upon the stockholder cannot be doubted.

Petitioner also urges that if the payments are not deductible from its gross income under Section 23(c), they are deductible under Section 23(d) as "taxes imposed upon a shareholder of the corporation upon his interest as shareholder which are paid by the corporation without reimbursement from the shareholder."[5] The Government responds that the Privilege Dividend Tax is not the kind of tax "upon his interest as shareholder" which Section 23(d) contemplates, and that in any event it is not one which is "paid by the corporation without reimbursement from the shareholder" within the meaning of the section. Since we think the Government is correct in the latter contention we have no occasion to consider whether this tax is one "upon his interest as shareholder."

The origins of the present Section 23(d) in the Revenue Act of 1921 disclose that its adoption was prompted by the plight of

[5] Section 23(d) provides: "Taxes of Shareholder Paid by Corporation.—The deduction for taxes allowed by subsection (c) shall be allowed to a corporation in the case of taxes imposed upon a shareholder of the corporation upon his interest as shareholder which are paid by the corporation without reimbursement from the shareholder, but in such cases no deduction shall be allowed the shareholder for the amount of such taxes."

various banking corporations which paid and voluntarily absorbed the burden of certain local taxes imposed upon their shareholders, but were not permitted to deduct those payments from gross income.[6] This history suggests it is the voluntary assumption of the burden of the tax, rather than acting as tax collector and paying it for another on whom the burden falls, which underpins the deduction. And this is plainly demonstrated by the requirement that to be entitled to the deduction the corporation must not be reimbursed by the shareholder for paying the tax. To pay the tax with sums which have been deducted and withheld from dividends declared and distributed amounts to obtaining the reimbursement which renders the deduction unavailable. Hence petitioner cannot prevail on Section 23(d).

Accordingly, the judgment is affirmed.

Mr. Justice ROBERTS took no part in the consideration or decision of this case.

Mr. Justice JACKSON.

Since I think this tax was not one on the corporation (See dissent in No. 620, *International Harvester Company* v. *Wisconsin Department of Taxation*, decided today), I see no basis for the corporation to claim a deduction under § 23(e) of the Revenue Act of 1934. The tax was on the stockholder, and it was paid by the corporation. The Company would be entitled to deductions under § 23(d) if it were not reimbursed. The credit given to the corporation against a declared dividend is in my opinion a "reimbursement" of the corporation for payment of the tax if the Wisconsin Taxing Act is valid. Notwithstanding dissenting views on that subject, I consider myself now bound by the conclusion of the Court. Hence I agree that no right to a deduction exists.

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[6] Hearings before Committee on Finance on H. R. 8245, U. S. Senate, 67th Cong., 1st Sess. 250-251. Compare, e. g., Elliot National Bank v. Gill, 218 Fed. 600 (C. C. A.); National Bank of Commerce in St. Louis v. Allen, 223 Fed. 472 (C. C. A.); First National Bank of Jackson, Miss. v. McNeel, 238 Fed. 559 (C. C. A.).